

NORTH AMERICAN GALVANIZING & COATINGS INC

Form 10-Q

August 08, 2003

=====

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

QUARTERLY REPORT UNDER SECTION 13 OR 15 (D)
OF THE SECURITIES EXCHANGE ACT OF 1934

FOR QUARTER ENDED JUNE 30, 2003

COMMISSION FILE NO. 1-3920

NORTH AMERICAN GALVANIZING & COATINGS, INC.
(formerly Kinark Corporation)
(Exact name of the registrant as specified in its charter)

DELAWARE
(State of Incorporation)

71-0268502
(I.R.S. Employer Identification No.)

2250 EAST 73RD STREET
TULSA, OKLAHOMA 74136
(Address of principal executive offices)

Registrant's telephone number: (918) 494-0964

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 and 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

YES NO

AMENDMENT

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

YES NO

END OF AMENDMENT

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of June 30, 2003.

Common Stock \$.10 Par Value 6,758,182

=====

NORTH AMERICAN GALVANIZING & COATINGS, INC.
AND SUBSIDIARY

Edgar Filing: NORTH AMERICAN GALVANIZING & COATINGS INC - Form 10-Q

INDEX TO QUARTERLY REPORT ON FORM 10-Q

	PAGE

PART I. FINANCIAL INFORMATION	
Forward Looking Statements or Information	2
Item 1. Financial Statements	
Independent Accountants' Review Report	3
Condensed Consolidated Balance Sheets as of June 30, 2003 (unaudited), and December 31, 2002	4
Condensed Consolidated Statements of Operations for the three and six-month periods ended June 30, 2003 and 2002 (unaudited)	5
Condensed Consolidated Statements of Cash Flows for the six months ended June 30, 2003 and 2002 (unaudited)	6
Notes to Condensed Consolidated Interim Financial Statements for the three and six-month periods ended June 30, 2003 and 2002 (unaudited)	7-13
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations	14-16
Item 3. Quantitative and Qualitative Disclosure About Market Risks	16-17
Item 4. Controls and Procedures	17
PART II. OTHER INFORMATION	18-19
SIGNATURES AND CERTIFICATIONS	20-22

FORWARD LOOKING STATEMENTS OR INFORMATION

Certain statements in this Form 10-Q, including information set forth under the caption "Management's Discussion and Analysis of Financial Condition and Results of Operations", constitute "Forward-Looking Statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Such statements are typically punctuated by words or phrases such as "anticipates," "estimate," "should," "may," "management believes," and words or phrases of similar import. The Company cautions investors that such forward-looking statements included in this Form 10-Q, or hereafter included in other publicly available documents filed with the Securities and Exchange Commission, reports to the Company's stockholders and other publicly available statements issued or released by the Company involve significant risks, uncertainties, and other factors which could cause the Company's actual results, performance (financial or operating) or achievements to differ materially from the future results, performance (financial or operating) or achievements expressed or implied by such forward-looking statements. Factors that could cause or contribute to such

Edgar Filing: NORTH AMERICAN GALVANIZING & COATINGS INC - Form 10-Q

differences could include, but are not limited to, changes in demand, prices, and the raw materials cost of zinc; changes in economic conditions of the various markets the Company serves, as well as the other risks detailed herein and in the Company's reports filed with the Securities and Exchange Commission. The Company believes that the important factors set forth in the Company's cautionary statements at Exhibit 99 to this Form 10-Q could cause such a material difference to occur and investors are referred to Exhibit 99 for such cautionary statements.

2

INDEPENDENT ACCOUNTANTS' REVIEW REPORT

To the Board of Directors and Stockholders of
North American Galvanizing & Coatings, Inc. (formerly Kinark Corporation):

We have reviewed the accompanying condensed consolidated balance sheet of North American Galvanizing & Coatings, Inc. and subsidiary ("NAGC" or the "Company") as of June 30, 2003, and the related condensed consolidated statements of operations for the three and six-month periods ended June 30, 2003 and 2002 and the condensed consolidated statements of cash flows for the six months ended June 30, 2003 and 2002. These interim financial statements are the responsibility of the Company's management.

We conducted our reviews in accordance with standards established by the American Institute of Certified Public Accountants. A review of interim financial information consists principally of applying analytical procedures to financial data and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with auditing standards generally accepted in the United States of America, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our reviews, we are not aware of any material modifications that should be made to such condensed consolidated interim financial statements for them to

Edgar Filing: NORTH AMERICAN GALVANIZING & COATINGS INC - Form 10-Q

be in conformity with accounting principles generally accepted in the United States of America.

We have previously audited, in accordance with auditing standards generally accepted in the United States of America, the consolidated balance sheet of North American Galvanizing & Coatings, Inc. and subsidiary as of December 31, 2002, and the related consolidated statements of operations and comprehensive income, stockholders' equity, and cash flows for the year then ended filed (not presented herein); and in our report dated February 7, 2003, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying condensed consolidated balance sheet as of December 31, 2002 is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

/s/Deloitte & Touche LLP
Tulsa, Oklahoma
August 4, 2003

3

NORTH AMERICAN GALVANIZING & COATINGS, INC. AND SUBSIDIARY CONDENSED CONSOLIDATED BALANCE SHEETS UNAUDITED

(DOLLARS IN THOUSANDS)	JUNE 30 2003	December 31 2002
<hr style="border-top: 1px dashed black;"/>		
ASSETS		
CURRENT ASSETS		
Cash	\$ 4	\$ 3
Trade receivables, net	4,680	4,529
Inventories	5,712	6,154
Prepaid expenses and other assets	811	618
Deferred tax asset, net	971	444
	<hr style="border-top: 1px dashed black;"/>	<hr style="border-top: 1px dashed black;"/>
TOTAL CURRENT ASSETS	12,178	11,748
	<hr style="border-top: 1px dashed black;"/>	<hr style="border-top: 1px dashed black;"/>
PROPERTY, PLANT AND EQUIPMENT, AT COST		
Land	1,473	1,714
Galvanizing plants and equipment	35,274	40,099
	<hr style="border-top: 1px dashed black;"/>	<hr style="border-top: 1px dashed black;"/>
	36,747	41,813
Less: Allowance for depreciation	13,134	16,203
Construction in progress	214	303
	<hr style="border-top: 1px dashed black;"/>	<hr style="border-top: 1px dashed black;"/>
TOTAL PROPERTY, PLANT AND EQUIPMENT, NET	23,827	25,913
	<hr style="border-top: 1px dashed black;"/>	<hr style="border-top: 1px dashed black;"/>
GOODWILL, NET OF ACCUMULATED AMORTIZATION	3,389	3,389
OTHER ASSETS	358	381
	<hr style="border-top: 1px dashed black;"/>	<hr style="border-top: 1px dashed black;"/>
TOTAL ASSETS	\$ 39,752	\$ 41,431
	<hr style="border-top: 1px dashed black;"/>	<hr style="border-top: 1px dashed black;"/>
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES		
Current maturities of long-term obligations	\$ 1,425	\$ 1,283
Current portion of bonds payable	634	617
Trade accounts payable	661	1,025

Edgar Filing: NORTH AMERICAN GALVANIZING & COATINGS INC - Form 10-Q

Accrued payroll and employee benefits	720	846
Other taxes	289	301
Other accrued liabilities	646	644
	-----	-----
TOTAL CURRENT LIABILITIES	4,375	4,716
	-----	-----
DEFERRED TAX LIABILITY, NET	1,054	1,187
LONG-TERM OBLIGATIONS	8,596	8,480
BONDS PAYABLE	6,964	7,283
SUBORDINATED NOTES PAYABLE	947	937
	-----	-----
TOTAL LIABILITIES	21,936	22,603
	-----	-----
COMMITMENTS AND CONTINGENCIES (NOTE 10)		
STOCKHOLDERS' EQUITY		
Common stock	819	819
Additional paid-in capital	17,438	17,464
Retained earnings	5,465	6,509
Common shares in treasury at cost	(5,906)	(5,964)
	-----	-----
TOTAL STOCKHOLDERS' EQUITY	17,816	18,828
	-----	-----
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$ 39,752	\$ 41,431
	=====	=====

See notes to condensed consolidated interim financial statements.

4

NORTH AMERICAN GALVANIZING & COATINGS, INC. AND SUBSIDIARY
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
UNAUDITED

(DOLLARS IN THOUSANDS EXCEPT PER SHARE AMOUNTS)	THREE MONTHS ENDED		SIX M
	2003	2002	2003
	-----	-----	-----
SALES	\$ 8,398	\$ 10,103	\$ 16,438
Cost of sales	5,835	6,857	11,837
Selling, general & administrative expenses	1,413	1,495	2,866
Depreciation expense	696	749	1,471
	-----	-----	-----
TOTAL COSTS AND EXPENSES	7,944	9,101	16,174
	-----	-----	-----
OPERATING INCOME	454	1,002	264
Interest expense, net	299	279	607
	-----	-----	-----
Income (loss) from Continuing Operations before income taxes	155	723	(343)
Income tax expense (benefit)	79	282	(130)
	-----	-----	-----

Edgar Filing: NORTH AMERICAN GALVANIZING & COATINGS INC - Form 10-Q

INCOME (LOSS) FROM CONTINUING OPERATIONS	76	441	(213)
Discontinued Operations:			
Loss on discontinued operations, net	(36)	(49)	(77)
Loss on write-off of assets of discontinued operations, net	(754)	--	(754)
	-----	-----	-----
NET INCOME (LOSS)	\$ (714)	\$ 392	\$ (1,044)
	=====	=====	=====
NET INCOME (LOSS) PER COMMON SHARE			
Continuing Operations:			
Basic	\$ 0.01	\$ 0.07	\$ (0.03)
Diluted	\$ 0.01	\$ 0.06	\$ (0.03)
Discontinued Operations:			
Basic	\$ (0.12)	\$ (0.01)	\$ (0.12)
Diluted	\$ (0.12)	\$ (0.01)	\$ (0.12)
Net Income (Loss):			
Basic	\$ (0.11)	\$ 0.06	\$ (0.15)
Diluted	\$ (0.11)	\$ 0.05	\$ (0.15)

See notes to condensed consolidated interim financial statements.

5

NORTH AMERICAN GALVANIZING & COATINGS, INC. AND SUBSIDIARY
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
UNAUDITED

(DOLLARS IN THOUSANDS)	SIX MONTHS ENDED JUNE 30	
	2003	2002
-----	-----	-----
OPERATING ACTIVITIES		
Net income (loss)	\$ (1,044)	\$ 616
Loss from discontinued operation	1,197	161
Depreciation	1,471	1,499
Deferred income taxes	(660)	--
Non-cash directors' fee	32	32
Changes in assets and liabilities:		
Accounts receivable, net	(151)	(995)
Inventories and other assets	272	(394)
Accounts payable, accrued liabilities and other	(500)	877
	-----	-----
NET CASH PROVIDED BY CONTINUING OPERATIONS	617	1,796
Net cash provided by discontinued operation	79	370
	-----	-----
CASH PROVIDED BY OPERATING ACTIVITIES	696	2,166
INVESTING ACTIVITIES		
Capital expenditures	(661)	(2,361)
	-----	-----

Edgar Filing: NORTH AMERICAN GALVANIZING & COATINGS INC - Form 10-Q

CASH USED IN INVESTING ACTIVITIES	(661)	(2,361)
FINANCING ACTIVITIES		
Proceeds from long-term obligations	8,095	6,051
Payments on long-term obligations	(7,827)	(6,418)
Payment on bonds	(302)	(287)
	-----	-----
CASH USED IN FINANCING ACTIVITIES	(34)	(654)
	-----	-----
INCREASE (DECREASE) IN CASH	1	(849)
CASH AT BEGINNING OF PERIOD	3	853
	-----	-----
CASH AT END OF PERIOD	\$ 4	\$ 4
	=====	=====

See notes to condensed consolidated interim financial statements.

6

NORTH AMERICAN GALVANIZING & COATINGS, INC. AND SUBSIDIARY
NOTES TO CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS
FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2003 AND 2002
UNAUDITED

NOTE 1. BASIS OF PRESENTATION

At the Company's Annual Meeting held on May 14, 2003, stockholders approved an amendment of the Company's certificate of incorporation to change the Company's name from Kinark Corporation to North American Galvanizing & Coatings, Inc., effective July 1, 2003.

The condensed consolidated interim financial statements included in this report have been prepared by North American Galvanizing & Coatings, Inc. ("NAGC" or the "Company") pursuant to its understanding of the rules and regulations of the Securities and Exchange Commission for interim reporting and include all normal and recurring adjustments which are, in the opinion of management, necessary for a fair presentation. The condensed consolidated interim financial statements include the accounts of the Company and its subsidiary.

Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to such rules and regulations for interim reporting. The Company believes that the disclosures are adequate to make the information presented not misleading. However, these financial statements should be read in conjunction with the financial statements and notes thereto included in the Company's Annual Report on Form 10-K, for the year ended December 31, 2002. The financial data for the interim periods presented may not necessarily reflect the results to be anticipated for the complete year.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the balance sheet dates and the reported amounts of revenues and expenses for each of the years. Actual results will be determined based on the outcome of future events and could differ from the estimates.

Edgar Filing: NORTH AMERICAN GALVANIZING & COATINGS INC - Form 10-Q

The Company's sole business is hot dip galvanizing and coatings which is conducted through its wholly owned subsidiary, North American Galvanizing Company ("NAG").

NOTE 2. NEW ACCOUNTING STANDARDS

In May 2003, the FASB issued Statement of Financial Accounting Standards No. 150, "Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity" ("SFAS No. 150"), which establishes standards for how an issuer classifies and measures in its statement of financial position certain financial instruments with characteristics of both liabilities and equity. It requires that an issuer classify a financial instrument that is within its scope as a liability, or an asset in some circumstances because that financial instrument embodies an obligation of the issuer. SFAS No. 150 is effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003. Management does not expect a material impact on the Company's consolidated financial position or results of operations upon adoption of this statement.

7

NOTE 3. STOCK OPTIONS

The Company accounts for its stock option plans in accordance with Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees", under which no compensation cost has been recognized for stock option awards. Had compensation cost for the Company's stock option plans been determined according to the methodology of Statement of Financial Accounting Standard No.123, "Accounting for Stock Based Compensation" ("SFAS No. 123"), the Company's pro forma net income (loss) and basic and diluted income (loss) per share for the six months ended June 30, 2003 and 2002 would have been as follows:

(DOLLARS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)	Six Months Ended June 30	
	2003	2002
Net Income (Loss), as reported	\$ (1,044)	\$ 616
Deduct: Total stock-based employee compensation expense determined under fair value based methods, net of tax	\$ (8)	\$ (6)
	\$ (1,052)	\$ 610
Pro forma net income (loss)		
Income (loss) per share:		
Basic - as reported	\$ (.15)	\$.09
Basic - pro forma	\$ (.16)	\$.09
Diluted - as reported	\$ (.15)	\$.08
Diluted - pro forma	\$ (.15)	\$.08

The fair value of options granted under the Company's stock option plans was

Edgar Filing: NORTH AMERICAN GALVANIZING & COATINGS INC - Form 10-Q

estimated using the Black-Scholes option-pricing model with the following assumptions used:

	Six Months Ended June 30	
	2003	2002
Volatility	66%	66%
Discount Rate	5%	5%
Dividend Yield	0%	0%
Fair Value	\$ 0.83	\$ 0.58

The Company issued stock options for 50,000 shares at \$1.50 per share and 45,000 shares at \$1.00 per share in the first six months of 2003 and 2002, respectively.

NOTE 4. INCOME (LOSS) PER COMMON SHARE

Basic income (loss) per common share for the periods presented are computed based upon the weighted average number of shares outstanding. Diluted income (loss) per common share for the periods presented are based on the weighted average shares outstanding, adjusted for the assumed exercise of stock options and warrants using the treasury stock method. The Company had a net loss for the three and six-month periods ended June 30, 2003 and the effect of including dilutive securities in the earnings per common share would have been anti-dilutive. Accordingly, options to purchase 676,199 and 677,397 common shares were excluded from the calculation of diluted loss per share for the three and six-month periods ended June 30, 2003, respectively.

8

Three Months Ended June 30	Number of Shares	
	2003	2002
Basic	6,756,452	6,713,632
Diluted	6,756,452	7,385,057
<hr style="border-top: 1px dashed black;"/>		
Basic	6,751,321	6,705,205
Diluted	6,751,321	7,376,068

NOTE 5. INVENTORIES

Inventories consist of raw zinc "pigs," molten zinc in galvanizing kettles and other chemicals and materials used in the galvanizing process. Inventories are stated at the lower of cost or market with market value based on estimated realizable value from the galvanizing process. Zinc cost is determined on a last-in first-out (LIFO) basis. Other inventories are valued primarily on an average cost basis.

NOTE 6. GOODWILL

The Company adopted the provisions of SFAS No. 141. "Business Combinations" and SFAS No. 142, "Goodwill and Other Intangible Assets" as required on January 1,

Edgar Filing: NORTH AMERICAN GALVANIZING & COATINGS INC - Form 10-Q

2002. On January 1, 2002, the Company ceased amortization of goodwill. During the second quarter of 2002, the Company completed its transitional goodwill impairment test in accordance with SFAS No. 142 for each reporting unit as of January 1, 2002, and determined that goodwill was not impaired. During the second quarter, the Company completed the annual impairment test of goodwill for 2003 and concluded goodwill was not impaired. The Company will complete the annual impairment test on goodwill during the second quarter of each year unless circumstances arise that require more frequent testing.

NOTE 7. BONDS PAYABLE

In 2000, the Company issued \$9,050,000 of Harris County Industrial Development Corporation Adjustable Rate Industrial Development Bonds, Series 2000 (the "Bonds") for the purchase of land and construction of a hot dip galvanizing plant in Harris County, Texas. The Bonds are senior to other debt of the Company.

The Bonds bear interest at a variable rate (5.25% at June 30, 2003) that can be converted to a fixed rate upon certain conditions outlined in the bond agreement. The Bonds are subject to sinking fund redemption, which was \$587,000 in 2002 and increases annually thereafter to a maximum redemption of \$960,000 on June 15, 2012. The Company makes monthly principal and interest payments of approximately \$86,000 into a sinking fund. The amount outstanding on these bonds was \$7,597,500 at June 30, 2003. The final maturity date of the Bonds is June 15, 2013. The Company has the option of early redemption of the Bonds at par unless the bonds are converted to a fixed interest rate, in which case they are redeemable at a premium during a period specified in the bond agreement. The Company's obligation under the bond agreement is secured through a letter of credit with a bank which must remain in effect as long as any Bonds are outstanding. The letter of credit is collateralized by substantially all the assets of the Company.

9

NOTE 8. SUBORDINATED DEBT

In February 2001, the Company completed a \$1,000,000 Private Placement of unsecured subordinated debt. The Company utilized the proceeds to partially fund construction of a new galvanizing facility in St. Louis, Missouri in 2002. Participation in the Private Placement was offered to accredited investors, which included the Company's directors and eligible stockholders holding a minimum of 100,000 shares of common stock. The amount outstanding on these notes, net of discount, was \$946,676 at June 30, 2003. The notes, which mature February 17, 2006 and bear interest at 10% payable annually, were issued with warrants to purchase 666,666 shares of common stock of the Company. Terms of the warrants, which expire February 17, 2008, permit the holder to purchase shares of the Company's common stock at any time prior to the expiration date. The exercise price of \$.856 per share reflects the fair value of the Company's common stock at the time the warrants were issued, as determined by an independent financial advisor. As of June 30, 2003 no warrants had been exercised.

NOTE 9. LONG-TERM OBLIGATIONS

(Dollars in Thousands)	June 30 2003	December 31 2002
-----	-----	-----
Revolving line of credit	\$ 4,960	\$ 4,390
Term loan	2,089	2,584
Advancing Construction Loan	2,889	2,768
9.5% note due 2015	21	21

Edgar Filing: NORTH AMERICAN GALVANIZING & COATINGS INC - Form 10-Q

Capital leases	62	---
	-----	-----
	\$ 10,021	\$ 9,763
Less current portion	1,425	1,283
	-----	-----
	\$ 8,596	\$ 8,480
	-----	-----

In November 2001, the Company amended a three-year bank credit agreement that was scheduled to expire in September 2002. Subject to borrowing base limitations, the amended agreement provides (i) a \$9,000,000 maximum revolving line of credit for working capital and general corporate purposes, (ii) a \$3,692,595 term loan and (iii) a \$3,000,000 advancing construction loan facility. In September 2002, the maturity of the revolving loan facility was extended to June 30, 2004 to coincide with the maturities of the term and advancing construction loans. Based on current discussions with the bank, the bank has formally agreed to extend the current agreement through October 1, 2004 and started the process to amend the credit agreement with the objective to ultimately extend its maturity to June 30, 2005.

Term loan payments are based on a three-year amortization schedule with equal monthly payments of principal and interest, and the loan may be prepaid without penalty. The revolving line of credit may be paid down without penalty, or additional funds may be borrowed up to the maximum line of credit. Payments on the advancing construction loan are based on a 108-month amortization schedule, plus interest, that commenced March 1, 2003, and the loan may be prepaid without penalty.

At June 30, 2003, \$9,939,000 was outstanding under the bank credit agreement, and \$500,000 was reserved for outstanding irrevocable letters of credit to secure payment of current and future workers' compensation claims. The Company had available borrowing capacity of \$48,000, net of outstanding irrevocable letters of credit, under the bank revolving line of credit based on the borrowing base calculated under the agreement.

10

Substantially all of the Company's accounts receivable, inventories, fixed assets and the common stock of its subsidiary are pledged as collateral under the agreement, and the credit agreement is secured by a full and unconditional guaranty from NAG. Amounts borrowed under the agreement bear interest at the prime rate of Bank One, Oklahoma or the LIBOR rate, at the option of the Company, subject to a rate margin adjustment determined by the Company's consolidated debt service coverage ratio. In the event the Company fails to maintain a consolidated debt service coverage ratio for any fiscal quarter of at least 1.25 to 1.00, the Applicable LIBOR Rate Margin will be increased to 5.75% and the Applicable Prime Rate Margin will be increased to 3.00%. Thereafter, the increased rate margin will remain in effect until such time as the Company has maintained a consolidated debt service coverage ratio greater than or equal to 1.25 to 1.00 for a subsequent fiscal quarter.

In the event the Company fails to maintain a consolidated EBITDA to capital expenditures plus current maturity of long-term debt ratio for any fiscal quarter of not less than 1.00 to 1.00, the increase in the Applicable LIBOR Rate Margin ranges from 3.75% to 5.75%, and the increase in the Applicable Prime Rate Margin ranges from 1.00% to 3.00%.

The credit agreement requires the Company to maintain compliance with covenant limits for current ratio, debt to tangible net worth ratio, debt service coverage ratio and a capital expenditures ratio. The Company was in compliance

Edgar Filing: NORTH AMERICAN GALVANIZING & COATINGS INC - Form 10-Q

with the covenants, at June 30, 2003.

NOTE 10. COMMITMENTS AND CONTINGENCIES

The Company has commitments with domestic and foreign zinc producers and brokers to purchase zinc used in its hot dip galvanizing operations. Commitments for the future delivery of zinc reflect rates then quoted on the London Metals Exchange and are not subject to price adjustment or are based on such quoted prices at the time of delivery. At June 30, 2003 the aggregate commitments for the procurement of zinc at fixed prices were approximately \$2.1 million. The Company reviews these fixed price contracts for losses using the same methodology employed to estimate the market value of its zinc inventory. The Company also had un-priced commitments for the purchase of approximately 934,000 pounds of zinc at June 30, 2003.

The Company's financial strategy includes evaluating the selective use of derivative financial instruments to manage zinc and interest costs. As part of its inventory management strategy, the Company expects to continue evaluating hedging instruments to minimize the impact of zinc price fluctuations. The Company had no derivative instruments outstanding at June 30, 2003 or December 31, 2002, and did not utilize derivatives in the six months ended June 30, 2003 or the year ended December 31, 2002.

The Company's total off-balance sheet contractual obligations at June 30, 2003, consist of \$2,837,717 for long-term operating leases for three galvanizing facilities and galvanizing equipment and approximately \$2,100,000 for zinc purchase commitments. The various leases for galvanizing facilities, including option renewals, expire from 2015 to 2017. A lease for galvanizing equipment expires in 2007.

NAG was notified in 1997 by the Illinois Environmental Protection Agency ("IEPA") that it was a potentially responsible party under the Comprehensive Environmental Response, Compensation, and Liability Information System ("CERCLIS") in connection with cleanup of an abandoned site formerly owned by Sandoval Zinc Co. The IEPA notice includes NAG as one of 59 organizations which arranged for the treatment and disposal of hazardous substances at Sandoval. Based on current information and the preliminary state of investigation, NAG's share of any probable future costs cannot be estimated at this time.

11

The Company is committed to complying with all federal, state and local environmental laws and regulations and using its best management practices to anticipate and satisfy future requirements. As is typical in the galvanizing business, the Company will have additional environmental compliance costs associated with past, present, and future operations. Management is committed to discovering and eliminating environmental issues as they arise. Because of the frequent changes in environmental technology, laws and regulations management cannot reasonably quantify the Company's potential future costs in this area.

The Company expenses or capitalizes, where appropriate, environmental expenditures that relate to current operations as they are incurred. Such expenditures are expensed when they are attributable to past operations and are not expected to contribute to current or future revenue generation. The Company records liabilities when remediation or other environmental assessment or clean-up efforts are probable and the cost can be reasonably estimated.

Various litigation arising in the ordinary course of business is pending against the Company. Management believes that resolution of the Company's litigation and environmental matters should not materially affect the Company's consolidated financial position or liquidity. Should future developments cause the Company to

Edgar Filing: NORTH AMERICAN GALVANIZING & COATINGS INC - Form 10-Q

record an additional liability for environmental matters, litigation or customer claims, the recording of such a liability could have a material impact on the results of operations for the period involved.

NOTE 11. LABOR AGREEMENT

NAG's one-year labor agreement with the United Steel Workers Union covering production workers at its Tulsa galvanizing plants originally expired March 31, 2003. The Company has not experienced any labor interruption and discussions between the union and NAG are continuing by mutual agreement.

NOTE 12. TREASURY STOCK

In the first six months of 2003, the Company issued 21,263 shares of its common stock from Treasury to outside Directors of the Company as payment for their quarterly board fee in lieu of cash payments of \$32,000. The shares were valued at the average closing price of NAGC's common stock for a prior 30-day period, as reported by the American Stock Exchange. Such shares were issued pursuant to the Directors' prior election and notice to the Company to receive up to all of their 2003 quarterly board fees in the Company's stock in lieu of cash. During 2002, the Company issued 56,094 shares for such purpose.

NOTE 13. RETIREMENT OBLIGATION

In the first quarter of 2002, the Company reversed the liability for a self-funded pension plan of \$119,000 upon the death of the sole participant covered by the plan.

NOTE 14. BUSINESS DEVELOPMENT

The lease term of a galvanizing facility occupied by one of NAG's subsidiaries expires July 31, 2003, and has not been renewed. NAG is seeking to exercise an option to purchase the facility and expects there will be no disruption to its galvanizing business being conducted at the facility.

12

NOTE 15. DISCONTINUED OPERATIONS

In 2002, the Board of Directors authorized the Company to pursue alternative uses for the Houston-Cunningham plant, which was temporarily idled in late 2001. Management believed the carrying value of the plant and the related galvanizing assets could be recovered through future operations of the plant. Accordingly, no write-down was recognized in 2002. However, in late April 2003, new events, combined with a further contraction of the galvanizing business in the Houston market, resulted in the likely inability to maintain the plant as part of the Company's continuing operations. As a result, the Company wrote-off its investment in the formerly idled Houston-Cunningham galvanizing plant in the second quarter ended June 30, 2003. The write-off resulted in a net loss on the abandoned assets of \$754,000, net of taxes of \$443,000. The net loss from operations for the Cunningham plant was \$77,000 and \$99,000, net of taxes of \$45,000 and \$62,000 for the six-months ended June 30, 2003 and 2002, respectively. The abandoned Cunningham plant has been classified as a discontinued operation and its expenses are not included in the results of continuing operations.

NORTH AMERICAN GALVANIZING & COATINGS, INC. AND SUBSIDIARY
ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS

North American Galvanizing & Coatings, Inc. (the "Company") is a leading provider of hot dip galvanizing and coatings for corrosion protection of fabricated steel products, through its wholly-owned subsidiary North American Galvanizing Company ("NAG").

During the quarter and six month periods ended June 30, 2003, there were no significant changes to the Company's critical accounting policies previously disclosed in Form 10-K.

RECENT DEVELOPMENTS

JULY 1, 2003 - Pursuant to approval received from the Company's stockholders at the annual meeting held May 14, 2003, the Company's name was changed from Kinark Corporation to North American Galvanizing & Coatings, Inc. The new name better describes the Company's core business and reflects the culmination of strategically refocusing the Company on hot dip galvanizing and coatings. The Board of Directors also believes the Company has developed a very recognizable brand name with North American Galvanizing, a name reflecting quality of product and service, and is positioned to capitalize on that asset.

DISCONTINUED OPERATIONS - In 2002, the Board of Directors authorized the Company to pursue alternative uses for the Houston-Cunningham plant, which was temporarily idled in late 2001. Management believed the carrying value of the plant and the related galvanizing assets could be recovered through future operations of the plant. Accordingly, no write-down was recognized in 2002. However, in late April 2003, new events, combined with a further contraction of the galvanizing business in the Houston market, resulted in the likely inability to maintain the plant as part of the Company's continuing operations. As a result, the Company wrote-off its investment in the formerly idled Houston-Cunningham galvanizing plant in the second quarter ended June 30, 2003. The write-off resulted in a net loss on the abandoned assets of \$754,000, net of taxes of \$443,000. The net loss from operations for the Cunningham plant was \$81,000 and \$99,000, net of taxes of \$45,000 and \$62,000, for the six-months ended June 30, 2003 and 2002, respectively. The abandoned Cunningham plant has been classified as a discontinued operation and its expenses are not included in

Edgar Filing: NORTH AMERICAN GALVANIZING & COATINGS INC - Form 10-Q

the results of continuing operations discussed below.

RESULTS OF OPERATIONS

The Company's second quarter 2003 galvanizing and coatings business recorded increased sales and returned to profitable continuing operations compared to the first quarter 2003 as order volume from fabricators began the expected, but gradual, improvement. Despite increased sales in the second quarter of 2003, the Company is still experiencing significantly lower demand for galvanizing compared to last year, a reflection of depressed economic conditions that began to impact the Company in mid-2002.

Sales for the second quarter of 2003 were \$8,398,000, a decrease of \$1,705,000, or 16.9% from second quarter 2002 sales of \$10,103,000. Total production volume in the second quarter of 2003, measured by tons of steel galvanized, decreased 22.4% from second quarter 2002 volume. Underlying production volume at the Company's galvanizing facilities varied significantly by region, with the weakness in some industrial markets still impacting small and medium fabricators.

Sales for the six-months ended June 30, 2003 were \$16,438,000 compared to sales of \$19,320,000 in the first six months of 2002, reflecting an 18.7% decrease in tonnage due to the weak economy impacting construction and fabrication activity requiring galvanizing. For the first six months of 2003, a continuation of downward

14

pressure on selling prices due to the weak market and competitive conditions, combined with increased natural gas costs, adversely impacted NAG's operations.

As stated in the Company's first quarter 10-Q Report, NAG's future prospects for increased galvanizing business in 2003, as reflected by a number of its customers, suggests a slight improvement for the remainder of this year. The Company, however, remains guarded as to the timing of any broad-based recovery due to weakness in long-range capital spending in a number of its major market sectors.

For the second quarter of 2003, the Company reported operating income, before interest expense and taxes, of \$454,000 compared to an operating income of \$1,002,000 in the second quarter of 2002. Gross profit of \$2,563,000 for the second quarter of 2003 decreased 21.0% from gross profit of \$3,246,000 for the second quarter of 2002. This quarter-to-quarter decrease in 2003 gross profit and operating earnings resulted primarily from lower volume associated with a weak economy.

Operating income for the six-months ended June 30, 2003 was \$264,000 compared to \$1,732,000 in the first six months of 2002, primarily due to lower sales and increased costs due to higher natural gas and insurance premiums.

Depreciation expense for the second quarter of 2003 was \$696,000 compared to \$749,000 for the same period of 2002.

The Company's selling, general and administrative expenses of \$1,413,000 for the second quarter of 2003 decreased 5.5% from \$1,495,000 for the second quarter of 2002, reflecting measures taken by management to align administrative overhead with the current level of sales.

Net interest expense for the second quarter of 2003 was \$299,000 compared to \$279,000 for the second quarter of 2002. The increase in interest expense for the second quarter of 2003 is primarily the result of financing for the

Edgar Filing: NORTH AMERICAN GALVANIZING & COATINGS INC - Form 10-Q

Company's new galvanizing plant in St. Louis which began production in 2003.

The Company's effective income tax rate for the second quarter of 2003 and 2002 were 51% and 39%, respectively. For the six months ended June 30, 2003 and 2002, the effective tax rates were 38% and 39%, respectively. The tax rate was adjusted in the second quarter of 2003 to bring the rate in line with an expected effective tax rate of 38% for 2003.

For the second quarter of 2003, income from continuing operations before income tax expense was \$155,000 compared to income before taxes of \$723,000 for the second quarter of 2002. For the six months ended June 30, 2003, the loss from continuing operations was \$213,000 compared to income of \$715,000 for the same period of 2002. The decrease in income in 2003 primarily reflects lower sales volume resulting from a measurable downturn in commercial, industrial and OEM capital spending.

The Company's net loss for the second quarter of 2003, including discontinued operations, was \$714,000, or \$.11 per share basic and diluted. This compared to second quarter 2002 net income of \$392,000, or \$.06 per share basic and \$.05 per share diluted. For the six months ended June 30, 2003, the Company reported a net loss \$1,044,000, or \$.15 per share basic and diluted.

15

LIQUIDITY AND CAPITAL RESOURCES

At June 30, 2003 the Company had approximately \$7,800,000 in net working capital and available borrowing capacity of approximately \$48,000 under a bank credit agreement. Under the this agreement, the Company maintains minimal cash balances through a daily "sweep" arrangement that automatically pays down or borrows against a revolving line of credit. Borrowing capacity on the revolver will vary significantly as a result of the daily sweep activity.

For the six months ended June 30, 2003, the Company's continuing operating activities generated cash of \$617,000 compared to cash generated of \$1,796,000 for the same period of 2002. The decrease in cash generated by 2003 activities is due primarily to a net loss and increases in deferred income taxes and working capital. Cash used in investing activities in the first quarter of 2003 of \$661,000 consisted of capital expenditures of \$423,000 to maintain current operating facilities and \$238,000 to complete construction of the new galvanizing plant in St. Louis, Missouri. The capital expenditures were funded by cash provided by operating activities and proceeds from an advancing construction loan. In the six months ended June 30, 2003, cash used in financing activities of \$34,000 primarily resulted from financing activities under a credit agreement with a bank.

The Company currently anticipates that cash flows from operations and borrowing under its revolving line of credit will be adequate to repay its debt obligations due within one year of approximately \$2,000,000, and for capital improvements to maintain current operating facilities.

ENVIRONMENTAL MATTERS AND OTHER CONTINGENCIES

The Company's facilities are subject to extensive environmental legislation and regulations affecting their operations and the discharge of wastes. The cost of compliance with such regulations in the first six months of 2003 and 2002 was approximately \$543,000 and \$598,000, respectively, for the disposal and recycling of waste acids generated by the galvanizing operations.

As previously reported, NAG was notified in 1997 by the Illinois Environmental Protection Agency ("IEPA") that it was a potentially responsible party under the

Edgar Filing: NORTH AMERICAN GALVANIZING & COATINGS INC - Form 10-Q

Comprehensive Environmental Response, Compensation, and Liability Information System ("CERCLIS") in connection with cleanup of an abandoned site formerly owned by Sandoval Zinc Co. The IEPA notice includes NAG as one of 59 organizations which arranged for the treatment and disposal of hazardous substances at Sandoval. Based on current information and the preliminary state of investigation, NAG's share of any probable future costs cannot be estimated at this time.

In the first quarter of 2003, a subsidiary of NAG, and other unrelated parties, was notified by a third party of a claim for environmental cleanup at a site leased by NAG in Tulsa, Oklahoma. NAG denies responsibility for contributing to the asserted cleanup and will undertake to be dismissed from the complaint.

The Company is committed to complying with all federal, state and local environmental laws and regulations and using its best management practices to anticipate and satisfy future requirements. As is typical in the galvanizing business, the Company will have additional environmental compliance costs associated with past, present and future operations. Management is committed to discovering and eliminating environmental issues as they arise. Because of the frequent changes in environmental technology, laws and regulations management cannot reasonably quantify the Company's potential future costs in this area.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISKS

The Company's operations include managing market risks related to change in interest rates and zinc commodity prices.

16

INTEREST RATE RISK. The Company is exposed to financial market risk related to changing interest rates, which will affect interest paid on its variable rate debt. At June 30, 2003 variable rate debt aggregating \$9,939,000 was outstanding under the credit agreement with an effective rate of 4.4% and \$7,598,000 was outstanding under the bond agreement with an effective rate of 5.25% (see Note 6 to Consolidated Financial Statements). In addition, the Company's fixed rate debt consisting of \$1,000,000 of 10% subordinated promissory notes was outstanding at June 30, 2003. The borrowings under variable rate facilities are due approximately as follows: \$990,000 in 2003; \$2,024,000 in 2004; \$8,589,000 in 2005 and \$5,934,000 in years 2006 through 2013. Each increase of 10 basis points in the effective interest rate would result in an annual increase in interest charges on variable rate debt of \$17,537 based on June 30, 2003 outstanding borrowings. The actual effect of changes in interest rates is dependent on actual amounts outstanding under the various loan agreements. The Company monitors interest rates and has sufficient flexibility to renegotiate the loan agreement, without penalty, in the event market conditions and interest rates change.

ZINC PRICE RISK. NAG enters into fixed price purchase commitments with domestic and foreign zinc producers to purchase a portion of its zinc requirements for its hot dip galvanizing operations. Commitments for the future delivery of zinc, typically up to one (1) year, reflect rates quoted on the London Metals Exchange. At June 30, 2003 the aggregate fixed price commitments for the procurement of zinc was approximately \$2,100,000. In addition, NAG had unpriced commitments to procure approximately 934,000 pounds of zinc in 2003. With respect to the fixed price purchase commitments, a hypothetical decrease of 10% in the market price of zinc from the June 30, 2003 level would represent a potential lost gross margin opportunity of approximately \$210,000; however, a favorable gross margin impact could result from a hypothetical upward price movement above these fixed price commitments. Additionally, lower zinc prices potentially could benefit future earnings for the unpriced commitments and uncommitted zinc purchases that could be made at lower market prices.

Edgar Filing: NORTH AMERICAN GALVANIZING & COATINGS INC - Form 10-Q

The Company's financial strategy includes evaluating the selective use of derivative financial instruments to manage zinc and interest costs. As part of its inventory management strategy, the Company expects to continue evaluating hedging instruments to minimize the impact of zinc price fluctuations. The Company had no derivative instruments outstanding at June 30, 2003 or December 31, 2002, and did not utilize derivatives in the quarter ended June 30, 2003 or the year ended December 31, 2002.

ITEM 4. CONTROLS AND PROCEDURES

The certifying officers of the Company are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the Company and have i) designed such disclosure controls and procedures to ensure that material information relating to the Company, including its consolidated subsidiaries, is made known to them by others within those entities, particularly during the period in which this quarterly report is being prepared; and ii) evaluated the effectiveness of the Company's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"). Based on this evaluation, the chief executive officer and the chief financial officer of the Company have concluded that the Company's disclosure controls and procedures were effective during the quarter being reported on in this quarterly report.

The Company's certifying officers have indicated that there were no significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of their most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

17

PART II OTHER INFORMATION

- Item 1. Legal Proceedings - Not applicable.
- Item 2. Changes in Securities - Not applicable.
- Item 3. Defaults Upon Senior Securities - Not applicable.
- Item 4. Submission of Matters to a Vote of Security Holders.

The Company held its Annual Meeting of Stockholders on Wednesday May 14, 2003 in New York City, NY. At the meeting, stockholders elected eight directors to serve a one-year term, ratified the Board of Directors' appointment of Deloitte & Touche LLP as the Company's independent accountants for the year ending December 31, 2003, and approved an amendment to the Company's certificate of incorporation to change the Company's name to: North American Galvanizing & Coatings, Inc. The votes for the election of directors were as follows:

	For	Withheld
	---	-----
Linwood J. Bundy	6,077,161	60,120
Paul R. Chastain	6,084,991	52,290
Ronald J. Evans	6,048,111	89,170
Gilbert L. Klemann, II	6,077,161	60,120
Patrick J. Lynch	6,077,161	60,120
Joseph J. Morrow	6,077,161	60,120
John H. Sununu	6,075,636	61,645
Mark E. Walker	6,085,021	52,260

Edgar Filing: NORTH AMERICAN GALVANIZING & COATINGS INC - Form 10-Q

Item 5. Other Information - Not applicable.

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits

- 3.1 The Company's Restated Certificate of Incorporation (incorporated by reference to Exhibit 3.1 to the Company's Pre-Effective Amendment No. 1 to Registration Statement on Form S-3 (Reg. No. 333-4937) file on June 7, 1996).
- 3.2 The Company's Amended and Restated Bylaws (incorporated by reference to Exhibit 3.2 to the Company's Quarterly Report on Form 10-Q dated March 31, 1996).
- 31 Certifications pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32 Certifications pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 99 Cautionary Statements by the Company Related to Forward-Looking Statements.

18

(b) Reports on Form 8-K

The Company filed three (3) Form 8-K Current Reports during the quarter ended June 30, 2003:

May 14, 2003 - Announcement of First Quarter 2003 Sales and Earnings Results.

May 21, 2003 - Announcement of Election of Directors at the Company's Annual Meeting of Stockholders held May 14, 2003, and Stockholders' approval to amend the Company's certificate of incorporation to change the Company's name to: North American Galvanizing & Coatings, Inc.

June 30, 2003 - Certificate of Amendment of Restated Certificate of Incorporation of Kinark Corporation, to change the Company's name to: North American Galvanizing & Coatings, Inc.

19

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized:

NORTH AMERICAN GALVANIZING & COATINGS, INC.

(Registrant)

/s/ Paul R. Chastain

Vice President and
Chief Financial Officer
(Principal Financial Officer)

Date: August 7, 2003

20

